

Federal Budget Developments

A YEAR after Congress passed the largest tax reduction in history—the Economic Recovery Tax Act of 1981—the Federal government was faced with mounting deficits over the next 3 years. As a means of reducing these deficits, Congress passed, in mid-August, the Tax Equity and Fiscal Responsibility Act of 1982; it was signed in early September. Over a 3-year period—calendar years 1982-84—the act provides \$75 billion in additional receipts, \$6 billion in net expenditures reductions, and hence a reduction of \$81 billion in the Federal deficit on the national income and product accounting (NIPA) basis (table 1).

Major features of the act are:

- Withholding of 10 percent on interest and dividend payments, effective July 1, 1983.
- Strengthening of compliance provisions, such as the reporting of State and local government income tax refunds.
- Modification of the deductions for medical expenses and casualty losses, generally effective January 1, 1983.
- Repeal of modified coinsurance transactions, effective January 1, 1982, and introduction of other changes that reduce insurance industry taxes.
- Repeal of safe-harbor leasing, effective January 1, 1984, and enactment of various other modifications and restrictions for leasing that are generally effective July 1, 1982.
- Modification and tightening of regulations governing long-term contract accounting, effective January 1, 1983 for new contracts.
- Temporary increases in airport and airway taxes, cigarette taxes, and telephone taxes.
- An increase in the wage base and tax rate for unemployment taxes, effective January 1, 1983.

- Extension of coverage to Federal employees of hospital insurance under medicare, effective January 1, 1983.
- Payment of supplemental unemployment benefits up to 10 additional weeks, effective September 12, 1982, through March 31, 1983; and
- Reduction in medicare and medic-aid spending, generally effective October 1, 1982.

Receipts

Receipts are increased in each of the 3 years: \$2.3 billion in 1982 (mostly in corporate profits tax accruals), \$31.9 billion in 1983, and \$40.9 billion in 1984.

Personal tax and nontax receipts

Personal tax and nontax receipts are increased \$18.0 billion in 1983 and \$15.7 billion in 1984. Withheld income taxes account for a significant part of the 1983 increase and more than account for the 1984 increase, largely due to the 10-percent withholding of interest and dividend payments. Various other compliance provisions, including the reporting of State and local income tax refunds, interest, and tips, also increase withholdings. The exemption of certain independent contractors, such as real estate agents, from withholding reduces taxes slightly.

Declarations and net settlements are increased by a number of provisions, although on balance they decline after 1983 due to the withholding provision for interest and dividends. As individuals pay taxes on interest and dividends throughout the year, their declarations and net settlements will be reduced.

Among the provisions increasing declarations and net settlements are the modifications to the deductions

for medical expenses and casualty losses. The act repeals, effective January 1, 1983, the deduction for one-half of health insurance premiums (up to \$150) and increases to 5 percent from 3 percent the amount by which medical expenses must exceed adjusted gross income to be deductible. The deduction for prescription drug costs exceeding 1 percent of adjusted gross income is also repealed, effective January 1, 1984. Thereafter, only legally prescribed drugs and insulin are deductible. The act establishes a new floor for casualty losses at 10 percent of adjusted gross income. Combined, these two provisions increase taxes \$2.3 billion in 1984. Repeal of the 15-percent add-on minimum tax and revision of the alternative minimum tax increases taxes \$0.7 billion. The reduction of the income thresholds—from \$20,000 to \$12,000 for single returns and from \$25,000 to \$18,000 for joint returns—that limits the inclusion of unemployment benefits in adjusted gross income increases taxes \$0.6 billion.

Corporate profits tax accruals

Corporate profits tax accruals are increased \$9.9 billion in 1983 and \$15.2 billion in 1984. A few of the provisions, particularly those relating to insurance (retroactively effective to January 1, 1982), affect taxes in 1982. The safe-harbor leasing modifications and restrictions, including restrictions on the amount of deductions for accelerated depreciation and the investment tax credit (generally effective July 1, 1982), increase corporate taxes \$3.7 billion in 1984. Other major provisions increasing these taxes are: (1) limitations on the tax benefits that arise from mergers and acquisitions; (2) modification and tightening of regulations governing long-term contract accounting; (3) requiring the amortization of construction interest and taxes over 10 years instead of allow-

ing deduction on a current basis; (4) modification to the investment tax credit, such as requiring deduction of one-half of the value of credits before computing depreciation for a new asset, instead of allowing the depreciation of the full value; and, (5) a 15-percent reduction, generally effective January 1, 1983, in several corporate tax preferences, such as deductions for mining exploration and development and for depletion of coal and iron ore.

Indirect business tax and nontax accruals

Indirect business tax and nontax accruals are increased \$5.1 billion in

1983 and \$5.7 billion in 1984. Various changes, generally effective from September 1, 1983 through December 31, 1987, increase airport and airway taxes; these changes include: (1) the 5-percent tax on domestic air passenger tickets is increased to 8 percent; (2) the 4-cents-per-gallon tax on other noncommercial aviation fuels is increased to 12 cents; (3) the imposition of a 14-cents-per-gallon tax on other noncommercial aviation fuels; (4) the reimposition of the 5-percent tax on air freight waybills; and (5) the reimposition of the \$3 per person international departure tax. Other excise tax increases are for cigarettes and telephone services. The tax of 4 cents per

package of cigarettes is doubled, effective January 1, 1983, through September 30, 1985. A special tax is also imposed on cigarette floor stocks removed before the effective date, and held for sale on that date. The current 1-percent telephone tax (which was scheduled to expire after 1984) is increased to 3 percent for calendar years 1983-85. The act also repeals a windfall profit tax adjustment for certain Alaskan oil, effective January 1, 1983.

Contributions for social insurance

Contributions for social insurance are increased \$3.9 billion in 1983 and \$4.8 billion in 1984. The increase in

Table 1.—Impact of the Tax Equity and Fiscal Responsibility Act of 1982 on Federal Receipts and Expenditures, NIPA Basis
(Billions of dollars)

	Calendar year			Seasonally adjusted at annual rates											
	1982	1983	1984	1982				1983				1984			
				I	II	III	IV	I	II	III	IV	I	II	III	IV
Receipts	2.3	31.9	40.9	0.9	1.4	1.6	5.6	22.4	23.6	42.2	39.5	38.7	40.4	41.9	42.7
Personal tax and nontax receipts	19.0	16.7	16.7					4.7	6.0	23.0	19.4	15.6	16.7	16.6	15.9
Withheld income tax	11.7	21.5	21.5					2.1	2.1	21.0	21.0	20.9	21.3	21.6	22.2
Compliance provisions:															
Interest and dividends	9.6	16.0	16.0					2.2	2.5	19.2	16.7	16.4	16.6	16.9	16.2
Other	2.4	2.0	2.0					2.5	2.5	2.8	2.8	2.9	2.9	2.9	2.9
Other	-2.4	-2.0	-2.0					-2.1	-2.1	-2.2	-2.2	-2.3	-2.3	-2.3	-2.3
Deductions and net settlements	1.5	-5.8	-5.8					2.5	2.9	1.4	-1.6	-5.5	-5.6	-5.9	-6.3
Compliance provisions:															
Interest and dividends	-1.6	-11.2	-11.2							-1.5	-4.5	-10.8	-11.0	-11.4	-11.8
Other		-4.4	-4.4									-4.4	-4.4	-4.4	-4.4
Increased enforcement	1.6	1.5	1.5					1.6	1.8	1.7	1.3	1.3	1.3	1.3	1.3
Unemployment benefits	7	7	7					8	7	7	7	7	7	7	7
Deduction for medical expenses	1	1.5	1.5					1	1	1	1	1.5	1.5	1.5	1.5
Deduction for casualty losses	7	7	7					7	7	7	7	7	7	7	7
Minimum tax	7	7	7					7	7	7	7	7	7	7	7
Other	4	4	4					2	4	4	6	8	9	9	1.0
Corporate profit tax accruals	1.8	9.9	16.2	9	1.9	1.2	4.0	9.0	9.7	10.1	10.5	12.2	14.8	16.2	16.6
Insurance provisions	1.1	1.5	2.8	9	1.0	1.2	1.3	1.4	1.5	1.5	1.6	2.1	2.5	2.9	2.9
Self-harbor leasing	5	2.1	3.7					2.0	2.1	2.1	2.2	2.8	3.4	4.0	4.6
Mergers and acquisitions	2	7	7					7	7	7	7	8	8	8	8
Long-term contract accounting	1.8	2.8	2.8					1.8	1.7	2.0	2.2	2.8	2.9	3.1	2.6
Construction interest and taxes	1.1	1.9	1.9					1.1	1.1	1.1	1.1	1.2	1.2	1.2	1.2
Investment tax credit	9	2.0	2.0					7	8	9	1.2	1.5	1.9	2.1	3.4
Corporate tax preferences	2	9	9					9	9	9	9	9	9	9	9
Other	9	1.3	1.3					9	9	9	9	1.2	1.9	1.9	1.3
Indirect business tax and nontax accruals	5	5.1	5.7				1.6	5.0	6.1	6.1	6.3	6.7	6.7	6.7	6.7
Airport and airway	4	1.2	1.4				1.2	1.2	1.2	1.2	1.2	1.4	1.4	1.4	1.4
Cigarettes	7	2.4	2.5				4	2.4	2.4	2.4	2.4	2.5	2.5	2.5	2.5
Telephone	1.3	1.5	1.5					1.3	1.3	1.3	1.3	1.5	1.5	1.5	1.5
Windfall profit tax	2	3	3					1	3	3	3	3	3	3	3
Contributions for social insurance	3.9	4.8	4.8					2.7	3.5	4.0	4.1	4.2	4.5	4.4	4.5
State unemployment insurance	2.2	2.3	2.3					2.1	2.2	2.2	2.3	2.3	2.3	2.3	2.3
Hospital insurance for Federal employees	1.9	1.7	1.7					1.6	1.6	1.6	1.6	1.7	1.7	1.7	1.7
Supplementary medical insurance	1	3	3							2	2	2	2	4	5
Expenditures	9	-2.4	-5.1			1	3.4	2.3	-2.6	-3.6	-3.9	-4.1	-4.7	-6.2	-6.3
Purchases of goods and services	8	8	8					8	8	8	8	8	8	8	8
National defense	3	4	4					3	3	3	3	4	4	4	4
Nondefense	5	4	4					5	3	3	3	4	4	4	4
Transfer payments to persons	1.0	-1.9	-4.8			1	2.8	2.1	-2.5	-3.4	-3.8	-3.9	-4.3	-4.7	-5.6
Medicare	-2	-2.7	-4.6				2.8	-1.7	-2.3	-3.4	-3.6	-3.9	-4.3	-4.7	-5.6
Supplemental unemployment benefits	1.2	1.9	4.8			1	4.8	4.0							
Other	-2	-2	-2				-1	-2	-2	-3					
Grants-in-aid to State and local governments	-2	-5	-5				-5	-5	-5	-5	-5	-5	-5	-5	-5
Medicaid	-1	-3	-3				-3	-3	-3	-3	-3	-3	-3	-3	-3
Other	-1	-2	-2				-2	-2	-2	-2	-2	-2	-2	-2	-2
Net interest paid	-3	-3	-3					-1	-3	-4	-5	-5	-5	-5	-5
Subsidies less current surplus of government enterprises	1	1	1				1	1	1	1	1	1	1	1	1
Surplus or deficit (-)	1.4	33.9	46.8	9	1.9	1.6	2.2	20.2	26.2	45.5	42.4	42.8	45.1	47.1	49.4

the unemployment tax wage base (to \$7,000 from \$6,000) and in the basic Federal tax rate (to 0.8 percent from 0.7 percent) increases contributions \$2.8 billion in 1984. The provision requiring Federal employees to pay the current 1.3 percent hospital insurance tax under medicare (on a wage base of \$35,100) will be matched by employing agencies, therefore doubling the impact on NIPA contributions. The act also provides for a temporary suspension of the limitation on annual increases in supplementary medical insurance premiums, effective July 1, 1983 and 1984.

Expenditures

Expenditures are increased \$0.9 billion in 1982 due to the temporary supplemental unemployment benefits, but are reduced \$2.0 billion in 1983 and \$5.1 billion in 1984.

The largest expenditure reduction is in transfer payments to persons, due to a number of provisions reducing medicare benefits. The largest of these is a limit on reimbursements to hospitals. Other provisions provide for private-sector utilization review and eliminate duplicate payments. Grants-in-aid to State and local governments are also reduced, largely in Medicaid. Medicaid grants are reduced primarily by permitting States to place liens on the property of permanently institutionalized beneficiaries in order to recover the cost of medical services,

and by limiting hospital reimbursements. Net interest paid is also reduced through various debt management techniques, including variable interest rates on savings bonds.

Purchases of goods and services and also subsidies less the current surplus of government enterprises are increased as a result of the extension of medicare hospital coverage to Federal employees. Under this provision (on the NIPA basis), the compensation of Federal employees will increase by the amount of the employer matching payments. It is very likely that agencies will have to absorb the matching payment and that these expenditures will not increase.

Other Budget Developments

Congress also passed in mid-August the Omnibus Budget Reconciliation Act of 1982, providing for an additional \$13.3 billion reduction in spending over the next 3 fiscal years. The major features of the act are: a \$4.5 billion reduction (over the next 3 fiscal years) in farm programs; a \$4.1 billion reduction in Federal employee retirement payments; and a \$1.9 billion reduction in food stamps.

The largest farm program reduction (\$4.2 billion) is for dairy price supports, or direct purchases of dairy products by the Commodity Credit Corporation. The savings will be achieved by freezing price supports

for fiscal years 1983 and 1984 and by reducing payments up to \$1 from the current price-support level of \$13.10 per hundred pounds in fiscal years 1983 and 1984, unless dairymen cut production sharply. The other farm program savings (\$0.3 billion) require new payments to farmers for not growing crops (wheat, feed grain, and rice). Detail was not available for a NIPA translation, but these reductions would reduce nondefense purchases and increase subsidies.

The reduction in Federal employee retirement payments will be achieved by a number of provisions. (1) Cost-of-living adjustments (COLA's) are reduced by 50 percent during the next 3 fiscal years for retirees below age 62. (2) The effective date of the COLA's in each of the next 3 years is delayed a month. Instead of paying COLA's on March 1 annually, they will be paid in April 1983, May 1984, and June 1985. (3) "Double-dipping" by military retirees who obtain Federal civilian jobs is eliminated by reducing the individual's civilian pay by the amount of the military COLA. (These provisions reduce NIPA transfer payments to persons.)

The reduction in food stamps will be achieved through a host of program changes, including a 1-percentage point reduction in COLA's in October 1982-84, and rounding benefits down to the next lowest dollar. (These provisions would also reduce NIPA transfer payments to persons.)